

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
<b>IRWIN AND MARGERY GAFFIN</b>	:	DETERMINATION
		DTA NO. 816778
for Redetermination of Deficiencies or for Refund of New	:	
York State Personal Income Tax under Article 22 of the		
Tax Law for the Years 1993, 1994 and 1995.	:	

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Petitioners, Irwin and Margery Gaffin, 172 Acorn Hill Road, P.O. Box 1355, Olivebridge, New York 12461, filed a petition for redetermination of deficiencies or for refund of New York State personal income tax under Article 22 of the Tax Law for the years 1993, 1994 and 1995.

A small claims hearing was held before Allen Caplowaith, Presiding Officer, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York on November 9, 1999 at 10:45 A.M. Petitioners appeared by William F. Berardi, CPA. The Division of Taxation appeared by Terrence M. Boyle, Esq. (Stanley Szozda).

Since neither party elected to reserve time to file a brief, the three-month period for the issuance of this determination began as of the date the hearing was held.

***ISSUES***

I. Whether the investment tax credits claimed by petitioners on their 1993, 1994 and 1995 New York State personal income tax returns are properly allowable.

II. Whether the Division of Taxation is barred from disallowing said claimed credits on the basis that the statute of limitations on assessments had expired.

***FINDINGS OF FACT***

1. During 1989, and through to the years at issue herein, Irwin and Margery Gaffin (hereinafter “petitioners”) were the major stockholders in Ameribag, Inc., a Subchapter S corporation engaged in the business of manufacturing leather goods.

2. Ameribag, Inc. (“Ameribag”) filed a Form CT-3-S, S Corporation Information Return, for the year 1989 on January 31, 1990. On this return, Ameribag claimed a total investment tax credit of \$14,817.00 relative to a factory building which was purchased by petitioners and leased to Ameribag. According to Schedule A of said return, petitioners owned 91% of the stock and one Benjamin Gaffin owned the remaining 9% of the stock. No depreciation for the factory building was claimed by Ameribag on this return. However, the hearing record contains another 1989 Corporation Information Return which is marked “Amended.” On this return, Ameribag did claim depreciation on the factory building. On Form 4562, Depreciation and Amortization, it was stated that “depreciation deduction reported by beneficial lessee under in substance owner treatment.” The record gives no indication whether this “Amended” return was actually filed. The first page of this return, which is a photocopy of the original with certain adjustments made by hand, bears no receipt date by the Division of Taxation (“Division”) other than that stamped on the original return, January 31, 1990.

3. For 1989, petitioners filed a joint New York State personal income tax return whereon they reported negative taxable income of \$18,902.00. On this return they claimed an investment tax credit pass through from Ameribag of \$13,483.00, which, due to the fact that they had no tax liability during 1989, was carried forward to future years.

4. The hearing record contains an Amended Resident Income Tax Return for 1989 whereon the only change made by petitioners was to claim depreciation and other related deductions attributable to the factory building which were not claimed on the original return. In the explanation section of said return petitioners stated that the “only changes are to confirm beneficial lessee of in-substance ownership treatment of mfg. facility.” The amended Schedule E, Supplemental Income and Loss schedule, contains the handwritten statement “Ownership of real estate & related deductions reported on return of beneficial lessee as in-substance owner treatment.” As with the 1989 corporate return, there is no indication in the hearing record that this “Amended” return was actually filed.

5. Petitioners filed timely New York State resident income tax returns for the years 1993, 1994 and 1995. On these returns, they claimed investment tax credits of \$7,212.00, \$7,504.00 and \$5,314.00, respectively. All of these credits represented carryover amounts from prior years.

6. On March 29, 1996, petitioners filed an Amended Resident Income Tax Return for each of the years 1993, 1994 and 1995 whereon their claimed investment tax credit carryover amounts were reduced to \$2,297.00, \$6,312.00 and \$5,314.00, respectively. The revised carryover amounts resulted from reduced computed tax liabilities available to which the credits could be applied. The reduced tax liabilities were based on additional deductions claimed by petitioners on the amended returns. These additional deductions were allowed and are not at issue herein. As part of their personal income tax returns, petitioners filed a Federal Schedule E for each of the years at issue whereon they reported the lease income derived from Ameribag. On each schedule they reported a depreciation deduction of \$10,039.00 on the factory building they leased to Ameribag.

7. On January 27, 1997, the Division of Taxation ("Division") issued a separate Statement of Proposed Audit Changes to petitioners for each of the years 1993, 1994 and 1995. For 1994 and 1995, the investment tax credit amounts claimed were disallowed in full. For 1993, the credit claimed of \$2,297.00 was allowed to the extent of \$1,793.00, resulting in a disallowed amount of \$504.00. The explanations provided on each of the above statements were identical and read, in pertinent part, as follows:

The investment credit is generally not allowed for New York State purposes with respect to leased property. The leasing of otherwise qualified property eliminates any potential credit to the lessor or lessee. Exception: When a lessee retains beneficial ownership and is entitled to take federal depreciation on the qualified property, the credit may be allowed.

8. On March 24, 1997, the Division issued a separate Notice of Deficiency to petitioners for each of the years 1993, 1994 and 1995 whereon it asserted New York State personal income tax of \$504.00, \$6,312.12 and \$5,314.00, respectively. These deficiencies are solely the result of the aforesaid disallowance of the investment credits claimed.

9. Subsequently, petitioners filed a Request for Conciliation Conference with the Division's Bureau of Conciliation and Mediation Services. On October 28, 1997, a conciliation conference was held. Subsequently, the conferee sent an explanatory letter to petitioners' representative with Consent forms sustaining the deficiencies. This letter, which was dated July 6, 1998, states as follows:

I have reviewed the lease agreement and mortgage that you forwarded, and also the New York State and Federal Regulations regarding Investment Tax Credits.

My conclusions are, that Mr. and Mrs. Gaffin, the lessor, cannot take the Investment Tax Credit because they have leased the property. According to Section 106.1(e) of the New York State Tax Regulations, the ITC is not allowed on property the taxpayer leases to any other person or corporation.

The regulation goes on to say that the lessee, Ameribag, may be entitled to the ITC if certain requirements are met, and the property otherwise qualifies for the purposes of ITC. To be considered qualified property, Section 106.1(c)(1)(iv) states that the property must be acquired by the taxpayer by purchase as defined in Section 179(d) of the Internal Revenue Code.

Section 179(d)(2)(B) of the Internal Revenue Code defines purchase as any acquisition of property, but only if the property is not acquired by one component member of a controlled group from another component member of the same group. When I reviewed the Tax Appeals Case, Hal & Julie Mitnick, it also directs me to Section 179(d)(2) of the Internal Revenue Code.

Based on the above, the ITC should not be allowed for the taxpayers or their Sub-S, Ameribag. During the conference, the question of the Statute of Limitations was brought up. The Statute had expired for the tax year 1989, but the deficiency is assessed for 1993, 1994 and 1995, which were all assessed prior to the expiration of the Statute of Limitations.

The Deficiency should be sustained in full.

10. Since petitioners failed to execute the Consent forms, the conferee issued a Conciliation Order on August 14, 1998 which denied their request and sustained the notices of deficiency.

11. On October 28, 1998, petitioners filed a petition for a hearing with the Division of Tax Appeals. Petitioners alleged therein as follows:

1. Investment Tax Credit involved was earned and claimed by taxpayers for calendar year 1989. Amounts disallowed for deficiencies issued was [sic] for unexpired carry forward of these 1989 credits. Conciliation Conferee stated and concluded the Statute on 1989 was expired.

2. Notwithstanding 1. taxpayers are entitled to investment tax credit as they are/were engaged in eligible business and owned and placed in service eligible business property. Taxpayers own the shares of Ameribag, Inc.- the "S" corporation and the real estate. Title and/or structural design of the acquisition of the factory property from an unrelated third party was done to satisfy the financing criteria of the U.S. Small Business Administration and Ulster County Development Corp. collectively the lenders who enabled taxpayers expansion and purchase of this property. Taxpayers are substantively the owners and users of the qualified property.

12. Neither the computations leading to the amounts claimed as investment tax credits nor the amounts claimed therefor during the years 1993, 1994 and 1995 are at issue. The only issue respecting the investment tax credits is whether or not petitioners are properly entitled to claim such credits on their personal income tax returns filed for said years.

13. During the hearing held herein, petitioners' representative submitted a written statement detailing his position with respect to the investment tax credit issue. In this statement he claimed that:

Regardless of the expired statute Ameribag was entitled to the Investment Tax Credit on the purchase of their factory building. The fact that the lenders who financed this acquisition including the US Small Business Administration required that the purchase be made collectively with the individual shareholders so they could better collateralize their position with the personal assets of the Petitioners, Ameribag was and remains the beneficial owner and is entitled to the in substance owner treatment permitted under Federal and State Income Tax Law. The fact that the Gaffins were required by their lenders to act in name only as lessors, and Ameribag as lessee does not change the substance of this investment by Ameribag the manufacturer.

14. Included in petitioners' Exhibit 1 are several documents, including the real estate lease between petitioners and Ameribag, the mortgage, note and various other financial documents which indicate that Ameribag was the beneficial owner of the factory building.

### ***CONCLUSIONS OF LAW***

A. Petitioners' argument that the Division is estopped from asserting deficiencies for the years 1993, 1994 and 1995 since the statute of limitations had expired for 1989, the year the investment tax credit was initially claimed, is without merit. Tax Law § 683 provides that a tax shall be assessed within three years after the return was filed and that a return filed before the last day prescribed by law shall be deemed filed on such last day. Accordingly, the returns filed for the years at issue are deemed filed on April 15<sup>th</sup> of the succeeding year.

It matters not that the investment tax credit carry over amounts claimed during the years at issue originated from the 1989 return. Since these amounts were claimed during the years at issue, 1993, 1994 and 1995, the statute is applicable to the returns filed for these years. Review of the record shows that the three notices of deficiency were issued on March 24, 1997, which was well within the period of limitations for assessments.

B. Income Tax Regulation § 106.1(c) defines the term “qualified property” for purposes of the investment tax credit allowance. Subsection (iv) of such section provides that the property, in order to be qualified, must be “acquired by the taxpayer by purchase as defined in subsection (d) of section 179 of the Internal Revenue Code.”

C. Income Tax Regulation § 106.1(e) provides as follows:

*Leased property.* Neither the investment credit nor the retail enterprise credit is allowed with respect to tangible personal property and other tangible property, including buildings and structural components of buildings, which a taxpayer leases to any other person or corporation. For purposes of the preceding sentence, any contract or agreement to lease or rent or for a license to use such property will be considered a lease. However, in cases where production property or a qualified rehabilitated building is leased in form and the lessee is in fact the beneficial owner and entitled to take Federal depreciation pursuant to section 167 of the Internal Revenue Code. . . . the lessee may be entitled to take the investment credit or the retail enterprise credit. Any election made with respect to such property pursuant to the provisions of section 168(f)(8) of the Internal Revenue Code, as such section was in effect for safe harbor lease agreements entered into prior to January 1, 1984, must be disregarded in determining whether a taxpayer shall be allowed a credit under this section.

D. Tax Law § 689(e) provides that in proceedings such as this, the burden of proof is on the petitioners. In the instant matter, it is accepted that Ameribag was the beneficial owner of the factory building. However, petitioners have not shown that Ameribag was “*entitled to take Federal depreciation pursuant to section 167 of the Internal Revenue Code*” (emphasis added). In fact, with respect to depreciation claimed on the factory

building, the hearing record is confusing. As previously stated, on the original 1989 corporate return of Ameribag, no depreciation was claimed. However, on an "Amended" 1989 return, which the record fails to show was actually filed, depreciation was claimed. With respect to petitioners' 1989 personal income tax returns the same holds true. On their original return no depreciation was claimed. However, on the "Amended" return, which the record fails to show was actually filed, depreciation was claimed. Whether this was merely a later attempt to comply with the requirements of Regulation § 106.1(e) is not known. Based on the above, it must be held that petitioners failed to sustain their burden of proof to show that Ameribag, in addition to meeting the other requirements of Regulation § 106.1(e), was entitled to take a deduction for depreciation of the factory building. Accordingly, it is concluded that Ameribag was not properly entitled to the investment tax credits claimed. Therefore, petitioners, as recipients of any flow-through investment tax credits from Ameribag, are likewise not properly entitled to the investment tax credits at issue herein.

E. The petition of Irwin and Margery Gaffin is denied and the three notices of deficiency issued March 24, 1997 are sustained.

DATED: Troy, New York  
February 3, 2000

/s/ Allen Caplowaith  
PRESIDING OFFICER